Supreme Court, U. S.
FILED
FEB 4 1978
MICHAEL RODAK, JR., CLERK

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1098

HARVEY L. BELL
SECURITIES COMMISSIONER
FOR THE STATE OF ARKANSAS ..... *Petitioner*

vs.

INTERNATIONAL TRADING, LTD.,
A DIVISION OF GNB, INC.,
J. R. ROSE AND ARTHUR PALMER ..... *Respondents*

## PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS

HARVEY L. BELL
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SECURITIES COMMISSIONER
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vs.

INTERNATIONAL TRADING, LTD.,
A DIVISION OF GNB, INC.,
J. R. ROSE AND ARTHUR PALMER ..... *Respondents*

---

## PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS

The Petitioner, Harvey L. Bell, Arkansas Securities Commissioner, respectfully prays that a Writ of Certiorari be issued to review the judgment and opinion of the Supreme Court of the State of Arkansas entered in this proceeding on October 3, 1977.

## OPINION BELOW

The opinion of the Supreme Court of the State of Arkansas is found in Volume 262 of the Arkansas Reports at page 244 and is also found in Volume 556 Southwestern Reporter, 2d edition at page 420. A copy of that opinion, along with a copy of that court's decree, appears in Appendix A hereto. No opinion was rendered by the Chancery Court of Pulaski County, Arkansas, the Court of original jurisdiction but the Order entered by that Court is attached as Appendix B hereto.

## JURISDICTION

The Judgment of the Supreme Court of the State of Arkansas was entered on October 3, 1977. A timely petition for rehearing *in banc* was denied on November 7, 1977, Appendix C hereto, and this Petition for Certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1257 (3).

## QUESTION PRESENTED

Whether the Commodity Futures Trading Commission Act of 1974 (CFTCA) preempted the State of Arkansas from enforcing the anti-fraud portion of its Securities Act against the seller of a London commodity option.

## STATUTORY PROVISIONS INVOLVED

United States Code Title 7:

*§ 2 Regulation of Trading and Exchange Activities.*



". . . provided, that the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of or is commonly known in the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to Section 5 of this Act or any other board of trade, exchange or market, in transactions subject to regulation by the Commission pursuant to Section 217 of the Commodity Futures Trading Commission Act of 1974: And provided further, that, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any state, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any state . . . ."

Ark. Stat. Ann. § 67-1247(1) (Repl. 1966). *Definitions of terms used.*

"Security" means any note; . . . evidence of indebtedness; certificate of interest or participation in any profit sharing agreement; . . . investment contract; . . . .

Ark. Stat. Ann. § 67-1235 (Repl. 1966). *Unlawful acts in connection with offer, sale or purchase of securities.*

It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly

(1) to employ any device, scheme or artifice to defraud

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, no misleading, or

(3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

Ark. Stat. Ann. § 67-1254 (Repl. 1966). *Enforcement of Act by Injunction or Mandamus.*

Whenever it appears to the Commissioner, upon sufficient grounds or evidence satisfactory to the Commissioner, that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this Act [The Arkansas Securities Act of 1959, as amended, Ark. Stat. Ann. § 67-1235 et seq. (Repl. 1966)] or any rule or order hereunder, he may summarily order the person to cease and desist from such act or practice, which order shall be effective for not more than 20 days during which time the Commissioner may apply to the Chancery Court of Pulaski County to enjoin the act or practice and to enforce compliance with this Act or any rule or order hereunder; however, the Commissioner may, without issuing a cease and desist order, apply directly to the Chancery Court of Pulaski County for the aforesaid relief. Upon a proper showing a permanent or temporary injunction,



restraining order, or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or the defendant's assets. The Court may not require the Commissioner to post bond.

## STATEMENT OF THE CASE

The original action in this case was filed on November 10, 1976 by the Petitioner, the Arkansas Securities Commissioner, seeking preliminary and permanent injunctions to restrain the Respondents from, among other things, violating Section 1 of the Arkansas Securities Act of 1959, as amended, the anti-fraud provision of the Arkansas Securities Act.

The Petition for Injunction filed by the Commissioner alleged that commencing in the spring of 1975, the Respondents sold London commodity options (options, traded on the London Commodity Options Exchange, to buy or sell commodity futures contracts) by various fraudulent means. The London commodity options were alleged to be investment contracts, evidences of indebtedness or participations in profit sharing agreements and hence securities as defined by Section 13(1) of the Arkansas Securities Act [Ark. Stat. Ann. § 67-1247 (Repl. 1966)]. An ex parte order was entered on November 16, 1976 setting a hearing for December 14, 1976 to consider the Petitioner's request for a preliminary injunction.

On December 6, 1976, the Respondents filed a Demurrer to the Petition for Injunction, based on two grounds. The first was that it appeared on the face of the Petition that the Chancery Court of Pulaski County, Arkansas had no jurisdiction of the subject matter of the action. This assertion was predicated on the Commodity Futures Trading Commission

Act of 1974 which established a new Federal regulatory agency, the Commodity Futures Trading Commission and conferred exclusive jurisdiction on the CFTC vis-a-vis the states and the Securities and Exchange Commission with respect to regulation of commodity options and commodity trading advisors. The second ground of the Demurrer was that the Petitioner lacked the legal capacity to bring the action.

Petitioner filed a Motion to Overrule the Demurrer on December 9, 1976. A hearing was held on December 14, 1976 at which the Petitioner presented testimony of three witnesses who had purchased commodity options from the Respondents. The Respondents maintained that their Demurrer should be sustained on the pleadings and presented no testimony in their behalf.

The first witness called by the Petitioner indicated that he had purchased a cocoa option from the Respondents for $3,000.00. The witness testified that it had been requested of him to sign a Power of Attorney so that the Respondents could trade his account in his name, but the witness refused. The witness testified that at some later date he contacted the Respondents seeking information concerning the cocoa market and how well his cocoa option was doing. He was informed that his cocoa option had been sold by the Respondents and that a sugar option had been purchased with the profit. The witness stated that he accepted a check in the amount of $574.00 representing the difference in the sale price of his cocoa option and the purchase price of the new sugar option but that he refused to invest further with the Respondents. Some months later the sugar option was abandoned by the Respondents and the witness lost all but $574.00 of his investment.



The second witness called by the Petitioner testified substantially as the first witness except that after initially refusing to sign the Power of Attorney this witness relented. He too lost all but $574.00 of his investment.

The third witness called by the Petitioner testified that he purchased an option from the Respondents based upon their "guarantee" that he would double his money. The option so purchased was later abandoned by the Respondents with this witness losing his entire investment.

At the conclusion of the evidence presented to the Chancellor, the Chancellor overruled the Demurrer and enjoined the Respondents from selling London commodity options by fraudulent or misleading means. The Chancellor did not, however, make a specific finding from the bench that the Respondents had engaged in fraudulent conduct.

The Respondents appealed to the Arkansas Supreme Court which reversed and dismissed the Petitioner's Complaint holding that the Petitioner had no standing to file suit and that the Chancery Court of Pulaski County, Arkansas, had no jurisdiction to entertain such suit because of the preemption of the entire commodities field by the enactment of the Commodity Futures Trading Commission Act of 1974.

## REASON FOR GRANTING WRIT

THE ENACTMENT OF THE COMMODITY FUTURES TRADING COMMISSION ACT OF 1974 HAS CREATED CONTROVERSY CONCERNING THE EXTENT TO WHICH STATES CAN ACT IN LIGHT OF THE "EXCLUSIVE JURISDICTION" OVER

## COMMODITIES TRANSACTIONS GRANTED TO THE COMMODITY FUTURES TRADING COMMISSION.

Prior to the effective date of the CFTCA, state securities regulators, the Securities and Exchange Commission and private litigants all sought to effect a measure of protection and/or recovery for investors defrauded through the offer, sale or purchase of commodities, commodity futures contracts or commodity options by asking courts to fashion remedies based on applicable securities acts. Such requests met with varying success.

The federal courts which entertained such suits based their decisions on an analysis of *Securities and Exchange Commission* v. *W. J. Howey & Company, et al.*, 328 U.S. 293 (1946). While the offer and sale of a commodities contract for future delivery standing alone was generally held not to involve the offer and sale of a "security", *Sinva, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 359 (S.D.N.Y. 1966), when that offer and sale was coupled with or made part of a managed or discretionary account, a claim cognizable under the securities acts was recognized by courts sitting in the Second Circuit, *Johnson* v. *Espey, et al.*, 341 F. Supp. 764 (S.D.N.Y. 1972), *Berman* v. *Orimex Trading, Inc.*, 291 F. Supp. 701 (S.D.N.Y. 1968), *Mahue* v. *Reynolds & Company*, 282 F. Supp. 423 (S.D.N.Y. 1967); courts sitting in the Fifth Circuit, *Securities and Exchange Commission* v. *Continental Commodities Corp.*, 497 F. 2d 516 (5th Cir. 1974), *McCurrin* v. *Kohlweger & Company, et al.*, 340 F. Supp. 1338 (E.D. La. 1972) aff. 477 F. 2d 113 (5th Cir. 1973), *Gould* v. *Barnes Brokerage Company, Inc.*, 345 F. Supp. 294 (N.D. Tex. 1972); courts sitting in the Eighth Circuit, *J. C. Booth* v. *Peavey Company Commodities Services*, 430 F. 2d 132 (8th Cir. 1970), *Marshall* v. *Lamson Brothers & Co., et al.*, 368 F. Supp. 486 (S.D. Ia. 1974),



*Schwartz* v. *Bache & Company, Inc.*, 340 F. Supp. 995 (S.D. Ia. 1972); and the Tenth Circuit Court of Appeals, *Commercial Iron & Metal Company* v. *Bache & Company et al.*, 478 F. 2d 39 (10th Cir. 1973). Such claims were however rejected by courts sitting in the Seventh Circuit, *Milnarik* v. *M.S. Commodities, Inc.*, 320 F. Supp. 1149 (N.D. Ill. 1970), *aff'd*, 457 F. 2d 274 (7th Cir. 1972) and *Hirk* v. *Agri-Research Council, Inc., et al.*, CCH, Sec. L Rep. par. 94, 738 (N.D. Ill. 1974) and further rejected by the District Court for the middle district of Pennsylvania, *Wasnowic* v. *Chicago Board of Trade*, 352 F. Supp. 1066 (M.D. Pa. 1972), *aff'd without opinion*, 491 F. 2d 752 (3rd Cir. 1973). The difference in opinion turned on the respective courts' interpretation of the common enterprise requirement necessary for a finding of an investment contract as defined in *Howey*, supra. The Seventh Circuit stated that there had to be a "pooling" of investor funds while the remaining Courts considering the problem stated that there need be only a common enterprise between the investor and promoter and not among investors similarly situated.

The Petitioner in the suit below alleged fraudulent discretionary transactions in respondents' customers' commodity options accounts and in addition alleged certain material misrepresentations and omissions in connection with the initial offer and sale of the commodity options themselves. A commodity option is a contract right, purchased from the option seller for a fee called the "premium," to buy from, or sell to, the option seller, the underlying commodity futures contract at a fixed price called the "striking price," at any time during the life of the option. The striking price is usually the market price of the underlying commodity futures contract on the day that the option contract is sold. The option period is usually fixed, ranging from one month to a year or 18 months. An option to sell the underlying commodity futures contract is known as a "put." An

option to buy the underlying commodity futures contract is known as a "call." It is also possible for the option purchaser to buy both a put and a call on the same commodity at the same time. Such a purchase is known as a "straddle," or, more commonly, as a "double option." Long, *The Naked Commodity Option Contract As A Security,* 15 Wm. & Mary L. Rev. 211, 212-14 (1974).

The purchaser of a call theoretically makes his profit when the market for the underlying commodity futures rises. If this occurs, he exercises his option, purchasing the underlying commodity futures contract from the option seller at the striking price and reselling it in the open market. His profit is the difference between the striking price and his selling price, less the premium he paid for the option. The purchaser of a put will profit similarly if the market falls sufficiently from the striking price for his profit on the futures contract to exceed the premium. *Id.* at 213. The purchaser of a double option will profit whether the market rises or falls, provided that the difference between the rise or fall and the striking price exceeds the premium he paid to the option seller.

Commodity option contracts in various forms have been present for a number of years. Before 1934, contracts on domestic commodities, such as wheat and cotton, were traded extensively on the major American exchanges. In that year, however, the Commodity Exchange Authority (CEA) banned trading in options on domestic commodities because of the abuses which had developed in the commodity option market. Trading in international, or "world" commodities, including silver, silver coins, platinum, cocoa, plywood, copper, coffee, and world sugar, was not affected, since such items were not subject to CEA jurisdiction. Long, *op. cit. supra,* pp. 213-14.



A distinction must be noted between "naked" commodity options which have no underlying futures contract and the London commodity options which were sold by respondents. The naked commodity option is an option issued by the seller for which there is no underlying futures contract. By the great weight of judicial authority, such options are securities. See: Long, *op. cit. supra,* p. 217.

In contrast to the naked option, the "London option" is an option on an underlying futures contract traded on the London commodity exchanges. The options are issued, or "written," by the same exchanges. "World" commodities such as sugar, cocoa, coffee, rubber, silver and copper are traded on the London exchanges. Such options too have been held to be securities. *Clayton Brokerage Co.* v. *Mouer,* 520 S.W. 2d 802, 804 (Tex. Civ. App. 1975), *rev'd on other grounds,* 531 S.W. 2d 805 (Tex. Sup. Ct. 1975).

While the issue of whether such London commodity options were securities within the meaning of the Arkansas Securities Act was pivotal in determining Petitioner's initial standing to bring suit, that question was left undecided by the Arkansas Supreme Court, *International Trading, Ltd. et al.* v. *Bell,* 556 S.W. 2d 420, 422 (1977) (Appendix "A" at page 22), and is therefore not pertinent here. For purposes of this Petition, Petitioner, like the Arkansas Supreme Court, assumes that such options are investment contracts. The question then presented concerns the Arkansas Court's analysis of 7 U.S.C.A. § 2 (Supp. 1977) which according to that Court . . . "seems . . . to express a clear intention to vest exclusive jurisdiction of the regulation of commodity options in the Commodity Futures Trading Commission and to supersede the jurisdiction of all state and federal agencies." *International Trading, Ltd.* v. *Bell, supra,* at 556 S.W. 2d page 423 (Appendix "A" at page 26).

Petitioner does not here challenge the ability of Congress to preempt the field of commodities regulation under the Commerce clause of the United States Constitution. See, e.g., *Hamilton* v. *Kentucky Distilleries and Warehouse Company*, 251 U.S. 145 (1919). Petitioner does however question the construction placed on that preemption by the Supreme Court of Arkansas and the CFTC.

The Court's attention is directed to the Report of the Senate Agriculture and Forestry Committee on H.J.R. Res. 335:

> The Committee wishes to make clear that the preemption of the regulation of commodity futures trading by the Commodity Futures Commission Act of 1974 does not prevent the States from enforcing their criminal anti-fraud statutes. The Committee realizes that many fraudulent schemes are devised to prey on the unsuspecting and unsophisticated investor. In many cases, these schemes purport to deal in commodities trading. The States are encouraged to continue to utilize their criminal anti-fraud statutes to discourage such schemes. (S. Rep. No. 74-73, 94th Cong., 1st Sess. [1975]).

The above section of the Senate report has been interpreted to permit State Courts to continue to adjudicate state criminal fraud cases. Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 Van. L. Rev. 1, 33 (Jan. 1976). Such interpretation is consistent with the position of the CFTC expressed on page 19 of their brief, amicus curiae, filed with the Arkansas Supreme Court in the instant case and is further consistent with the position of the Arkansas Court as expressed on 556 S.W. 2d page 425 (Appendix "A" at page 29). Petitioner has been unable to find justification for the distinction drawn by



the CFTC which would allow enforcement of some state anti-fraud statutes yet preempt others. If in fact "all state and federal agencies" have been preempted, logic would seem to indicate that no state statute nor any federal statute, save the CFTCA, could be enforced against persons effecting fraudulent transactions in commodities. A ludicrous extension of that position would be to preempt any local law enforcement agency from taking action against thieves who were stealing raw commodities.

It is apparent from reading law review articles and CFTC memorandums that it is state securities regulators and the SEC that the commodities industry and the CFTC wish preempted. All other federal, state and local agencies are allowed by the CFTC to enforce their statutes.

It is the position of the Petitioner that if general anti-fraud statutes can be enforced against fraudulent commodities brokers then specific anti-fraud statutes prohibiting fraud in connection with the offer and sale of investment contracts should also be enforced.

Congress in enacting the CFTCA did not enact legislation preempting selected agencies. If Congress declares that a particular agency has exclusive jurisdiction, then there is no room for other agencies to regulate in that field. As stated by the Eighth Circuit Court of Appeals in *Northern States Power Company* v. *Minnesota*, 447 F. 2d 1143 (8th Cir. 1971):

> "Where Congress has unequivocally and expressly declared that the authority conferred by it is exclusive, then there is no doubt but that states cannot exert concomitant or supplementary regulatory authority over the identical activity." *Northern States*, supra, at 1146.

The question then presented is whether the Arkansas Securities Commissioner by filing suit to enjoin fraudulent sales of investment contracts in the form of London Commodity Options is "regulating" the offer and sale of those options within the meaning of *Northern States Power Company*, supra., or whether he is simply enforcing an anti-fraud statute compatible with the Senate report cited above.

The Arkansas Securities Commissioner is not seeking to license persons or otherwise regulate London Commodity Options but rather he, as the representative of the State of Arkansas, is seeking to prohibit through injunction certain fraudulent conduct.

Petitioner submits it was not the intent of Congress to preempt the State of Arkansas from enforcing Arkansas' securities fraud laws by passage of the CFTCA. The State of Arkansas seeks to enforce a securities fraud law — not to regulate commodities. Congress never intended to deny the State of Arkansas and its courts the right to protect Arkansas citizens from perpetrators of fraud and deceit. Such malefactors should and must be enjoined from engaging in fraudulent businesses entirely.

The Court's attention is directed to Section 21 of the Arkansas Securities Act [Ark. Stat. Ann. § 671255 (Supp. 1977)] which provides criminal sanctions for persons who willfully violate that Act.

It is inconsistent to hold that the State of Arkansas, pursuant to Ark. Stat. Ann. § 41-2203 (Crim. Code 1976), a general "theft by deception" statute, can prosecute persons engaging in fraudulent commodities operations, *International Trading, Ltd.* v.



*Bell*, supra at 556 S.W. 2d page 425 (Appendix "A" at page 29), but cannot so prosecute under Ark. Stat. Ann. § 67-1235 (Repl. 1966), the Securities Act "anti-fraud" section, due to the "clear intention [of Congress] to vest exclusive jurisdiction of commodity options in the Commodity Futures Trading Commission and to supersede the jurisdiction of all state and federal agencies." *International Trading, Ltd.* v. *Bell*, supra, at 556 S.W. 2d page 423 (Appendix "A" at page 26). Either the State of Arkansas has been preempted or it has not.

Petitioner believes the more reasoned approach to this inconsistency is to recognize the grant of exclusive jurisdiction to "regulate" commodities in the CFTC but to allow the enforcement of anti-fraud statutes by the states whether those statutes are grounded in the general common law or contained in other specialized statutes such as the Securities Acts. Certainly, if state anti-fraud enforcement and federal regulation become inconsistent, federal preemption would apply. The Petitioner is not seeking to interfere with the federal regulatory scheme over the commodities industry but only is seeking to protect the Arkansas investors from fraud. Surely Congress could not have meant to deny him that ability.

## CONCLUSION

For the reasons hereinabove stated, Petitioner respectfully submits that his Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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## APPENDIX "A"

### REVERSALS CHANCERY DISTRICTS

STATE OF ARKANSAS,
SCT.
In the Supreme Court

BE IT REMEMBERED, That a term of the Supreme Court of the State of Arkansas, begun and held at the Court House, in the City of Little Rock, on the 3rd day, being the first Monday of October, A.D. 1977, amongst others, were the following proceedings, to-wit: On the 3rd day of October, A.D. 1977, a day of said term:

International Trading Ltd.,
a division of GNB, Inc. et al
Appellant

No. 77-96 vs.

Harvey L. Bell, Securities Commissioner
Appellee

Appeal from Pulaski Chancery Court
Second District

THIS CAUSE came on to be heard upon the transcript of the record of the Chancery Court of Pulaski County, Second District, and was argued by solicitors; on consideration whereof it is the opinion of the Court that there is error in the proceedings and decree of said Chancery Court in this cause as set out in the opinion herein delivered October 3, 1977.

IT IS THEREFORE ORDERED AND DECREED by the Court that the decree of said Chancery Court in this cause rendered be, and the same is hereby reversed, annulled and set aside with costs; and that this cause be dismissed.

IT IS FURTHER ORDERED AND DECREED, That said appellants recover of said appellee all their costs in this Court in this cause expended, and have execution thereof.

IN TESTIMONY, That the above is a true copy of the decree of said Supreme Court rendered in the case therein stated, I, Jimmy H. Hawkins, Clerk of said Supreme Court, hereunto set my hand and affix the Seal of said Supreme Court, at my office in the City of Little Rock, this 7th day of November, A.D. 1977.

JIMMY H. HAWKINS
Clerk
By Dona L. Williams
D.C.



SUPREME COURT OF ARKANSAS

INTERNATIONAL TRADING LTD.,
A Division of GNB, Inc.:
GNB, Inc., J. R. ROSE and Arthur PALMER
*v.* Harvey L. BELL, Securities
Commissioner for the State of
Arkansas

77-96

Opinion delivered October 3, 1977
(In Banc)

Appeal from Pulaski Chancery Court, Second Division, *John T. Jernigan*, Chancellor; reversed and dismissed.

JOHN A. FOGLEMAN, Justice. The chancery court enjoined appellants from directly or indirectly employing any device, scheme or artifice to defraud; making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, or, engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. In doing so, the court overruled appellants' demurrer. Appellants elected to stand on that demurrer, which alleged that it appeared on the face of the complaint that the court had no jurisdiction of the subject matter and that appellee did not have the legal capacity to sue in this ac-

tion. Since we find that the chancery court erred in overruling this demurrer, we must reverse the decree.

The complaint was filed by the Securities Commissioner for the State of Arkansas under the Arkansas Securities Act, as amended [Ark. Stat. Ann. § 67-1235 et seq]. In it, he alleged that International Trading, Ltd., a division of GNB, Inc., GNB, Inc., J. R. Rose and Arthur Palmer were engaging in acts and practices and a course of conduct which constitute violations of various sections of the act in offering and selling a type of commodity option contracts known as "London commodity options." He alleged that these acts and practices constituted a device, scheme or artifice to defraud and would operate as a fraud or deceit upon the purchasers of options and that appellants made misrepresentations of material facts or omitted to state material facts necessary to make the statements made not misleading in the light of the circumstances under which they were made. The acts and conduct specified were:

(a) engaging in an organized statewide, high-pressure, "boiler room" like sales campaign, conducted primarily by repeated, unsolicited, "cold-canvass" long distance telephone calls to persons who were inexperienced and unsophisticated as to London commodity options transactions, in which calls false and deceptive statements were made about profit expectations and the advisability of immediate purchase of such options to take advantage of purported favorable market prices for the options;

(b) hiring and directing sales persons without experience or knowledge of the risks and trading mechanics involved in such options and providing these salesmen with glowing, but deceptive and misleading "canned" sales speeches to be read to potential customers over the telephone, instructing these salespersons to conceal material facts, avoid unfavorable ex-



planations, provide only minimal information, and tell these prospects anything to make a sale;

(c) representing and making it appear that the options being offered and sold would be purchased in the London market in the names of such customers, with the company acting as the purchaser's agent, when in fact the options were purchased in the name of the company for its own account at prices substantially less than the customers paid the company;

(d) representing, without any reasonable basis, profits or returns which would double or triple the purchase price in a short period of time, but failing to disclose that many customers had actually lost their investments;

(e) concealing and misrepresenting the true nature of the purchase price, including all fees and markups, which customers pay to the company for the purchase of London commodity options; concealing the fact that the company marks up the price of each option purchased in the London markets between 40 and 150 percent;

(f) representing to purchasers and prospective purchasers that the company's salespersons are well trained and have several years' experience in the commodity option field, when, in fact, most of them have had substantially less than one year's experience and the company provides no meaningful training to such salespersons, who are not specialists in the field of commodity options;

(g) failing to state that International Trading, Ltd., a division of GNB, Inc., and GNB, Inc. are foreign corporations not authorized to do business in Arkansas;

(h) failing to disclose the risk of loss to potential investors;

(i) failing to disclose that the investors were purchasing a commodity option rather than a true contract for future delivery of commodities;

(j) failing to disclose the actual closing date for transactions traded on the London Board of Options Exchange;

(k) using high pressure telephonic sales techniques emphasizing the likelihood of profits and not considering the investment needs of the customer;

(l) excessively marking up the price of the London commodity options sold to Arkansas investors;

(ll) receiving compensation directly and indirectly for advising potential investors as to the value of these securities and employing a device, scheme or artifice to defraud and engaging in acts, practices or course of business which operated or would operate as a fraud or deceit upon purchasers in violation of Ark. Stat. Ann. § 67-1236 (a) (Repl. 1966) by omitting to state the material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

The court heard appellee's evidence on the allegations of fraud, but appellants, having elected to stand upon their demurrer, offered no evidence. Even so, the chancellor declined to make a finding that appellants had been guilty of fraud. The language of the decree stating the acts enjoined is couched entirely in words of § 1 of the Arkansas Securities Act [Ark. Stat. Ann. § 67-1235 (Repl. 1966)] declaring those acts, in connection with the offer, sale or purchase of securities to be unlawful.

For the purposes of this opinion we assume, but do not decide, that a London commodity option is a security, as



alleged in appellee's complaint and defined by Ark. Stat. Ann. § 67-1247 (1). If it is, it would be subject to regulation under the Arkansas Securities Act, except for the preemption of the field by the United States Congress through the Commodity Futures Trading Commission Act, an amendment to the Commodity Exchange Act. 7 USCA § 1 et seq.

In order to understand the question presented, it is necessary that certain terms, not generally familiar, be defined, as we understand them.

A commodity futures contract is a contract by which a seller agrees to deliver a definite quantity of a commodity in a specified future month, and the purchaser agrees to accept and pay for the commodity when it is delivered. The terms of the contract, except for the price, are fixed by the organized exchange through which the trading is done. Campbell, Trading in Futures Under the Commodity Exchange Act, 26 George Washington Law Review 215, 216-218. The price is determined by open bidding by traders on the floor of the commodity exchange. See *Clayton Brokerage Co. of St. Louis* v. *Mouer*, 520 S.W. 2d 802 (Tex. Civ. App., 1975); § 7 USCA §§ 6, 6b, 6c, Supp. 1977.

A commodity option is a contract right, purchased from the option seller for a fee called the "premium," to buy from, or sell to, the option seller, the underlying commodity futures contract at a fixed price called the "striking price," at any time during the life of the option. The striking price is usually the market price of the underlying commodity futures contract on the day that the option contract is sold. The option period is usually fixed, ranging from one month to a year or 18 months. An option to sell the underlying commodity futures contract is known as a "put." An option to buy the underlying commodity futures contract is known as a "call." It is also possible for the option purchaser to buy both a put and a call on the same commodity at the same time. Such a purchase is known as a "straddle," or, more commonly, as a

"double option." Long, The Naked Commodity Option Contract as a Security, 15 Wm. & Mary L. Rev. 211, 212-14 (1974).

The purchaser of a call theoretically makes his profit when the market for the underlying commodity futures rises. If this occurs, he exercises his option, purchasing the underlying commodity futures contract from the option seller at the striking price and reselling it in the open market. His profit is the difference between the striking price and his selling price, less the premium he paid for the option. The purchaser of a put will profit similarly if the market falls sufficiently from the striking price for his profit on the futures contract to exceed the premium. Id. at 213. The purchaser of a double option will profit whether the market rises or falls, provided that the difference between the rise or fall and the striking price exceeds the premium he paid to the option seller. A commodity option is considered a more conservative investment than a commodity futures contract because the risk of loss is limited to the premium paid and is not a concomitant of price fluctuations in the commodity which may lead to additional margin calls. Note, Federal Legislation for Commodity Option Trading: A Proposal, 47 So. Cal. L. Rev. 1418, 1424-25 (1974).

Commodity option contracts in various forms have been present in the financial market place for a number of years. Before 1934, contracts on domestic commodities, such as wheat and cotton, were traded extensively on the major American exchanges. In that year, however, the Commodity Exchange Authority (CEA) banned trading in options on domestic commodities because of the abuses which had developed in the commodity option market. Trading in international, or "world" commodities, including silver, silver coins, platinum, cocoa, plywood, copper, coffee, and world sugar, was not affected, since such items were not subject to CEA jurisdiction. Long, cit. supra, pp. 213-14.



A London option is a right, for a price, to purchase or sell a commodity futures contract for a specified term at a specified price. Thus it is simply an extention of a commodity futures contract and is traded on the same London commodity exchanges as the underlying futures contract. World commodities traded on the London exchange include sugar, cocoa, coffee, rubber, silver and copper. See *Clayton Brokerage Co. of St. Louis, Inc.* v. *Mouer*, supra, appeal dismissed as mooted by reason of preemption by Commodity Futures Trading Commission Act of 1974, 531 S.W. 2d 805. For other discussions defining these terms and the commodity trading business, see *British American Commodity Operations Corp.* v. *Bagley*, 552 F. 2d 482 (2 Cir., 1977). For a discussion of the London option market and the sale of London options in the United States, see Long, Commodity Options — Revisited, 25 Drake L. Rev. 75, 111-128 (1975).

The language which we find to be a clear manifestation of the intention of Congress to exclude states from this field is found in provisos added to the Commodity Exchange Act by the Commodity Future Trading Act as set out in 7 USCA § 2 (Supp. 1977). They are:

> *** *Provided*, That the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 15a of this title: *And provided further*, That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the

United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State. ***

The language seems to us to express a clear intention to vest exclusive jurisdiction of the regulation of commodity options in the Commodity Futures Trading Commission and to supersede the jurisdiction of all state and federal agencies. Our conclusion is fortified by another section of the act, now appearing as 7 USCA 6c (b) (Supp. 1977), where Congress said:

No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this chapter, but not specifically set forth in section 2 of this title, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe within one year after the effective date of the Commodity Futures Trading Commission Act of 1974 unless the Commission determines and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture that it is unable to prescribe such terms and conditions within such period of time: *Provided*, That any such order, rule, or regulation may be made only after notice and opportunity for hearing: *And provided further*, That the Commission may set different terms and conditions for different markets.



This view is further strengthened by the report of the Congressional Conference Committee on the House and Senate versions of the bill for the act in question. That committee said:

The clarifying amendments make clear that (a) the Commission's jurisdiction over futures contract markets or other exchanges *is exclusive and includes the regulation of . . . commodity options;* [and] (b) *the Commission's jurisdiction, where applicable, supersedes State as well as Federal agencies . .*

Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned . . . . *In view of the broad grant of authority to the Commission to regulate the futures trading industry, the Conferees do not contemplate that there will be a need for any supplementary regulation by the States.* [Emphasis ours.]

See Senate Miscellaneous Reports on Public Bills, IX, Sen. Rep. 1178-1239, 93d Congress, 2d Session, pp. 35-36; see also, *Securities and Exchange Commission* v. *American Commodity Exchange, Inc.*, 546 F. 2d 1361 (10 Cir., 1976) for other legislative history.

The vesting of exclusive jurisdiction is a clear indication that Congress intended no regulation in this field except under the authority of the act. See *Rice* v. *Santa Fe Elevator Co.*, 331 U.S. 218, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947); Johnson, Commodity Futures Trading Act: Preemption as Public Policy, 29 Vanderbilt L. Rev. 1, 2, 20.

Where the act conferred jurisdiction on the commission, at least one other court has held that it preempted the field of regulation insofar as the states are concerned. *State* v. *Monex International, Limited*, 527 S.W. 2d 804 (Tex. Civ. App., 1975).

applied to London commodity options in *Clayton Brokerage Co. of St. Louis* v. *Moeur*, 531 S.W. 2d 805 (Tex. Sup. Ct., 1975). It has also been held that the act stripped the Securities Exchange Commission of authority previously vested in it. *Securities Exchange Commission* v. *Univest, Inc.*, 405 FS 1057 (DC, Ill., 1975), 410 FS 1029, remanded 556 F. 2d 584 (7 Cir., 1977). There is at least tacit recognition of the preemption in some cases in which it has beeh held that pending actions or actions taken before the newly created commission could act were not affected. See, e.g., *State* v. *Spannus Coin Wholesalers, Inc.*, 250 N. W. 2d 587 (1976).

Appellee makes some very appealing arguments in seeking to sustain his position that there is no preemption. First, he seizes upon the clause stating that "except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on . . . other regulatory authorities under the laws . . . of any State or (ii) restrict . . . such other authorities from carrying out their duties and responsibilities in accordance with such laws," and the statement that "[n]othing in this act shall be deemed to supersede or limit the jurisdiction conferred on courts of . . . any state." The argument that the exception relates only to regulation of commodities, not securities, is unavailing here because of the clear language of the act bringing commodity options within the purview of the act. The exception, then, eliminates the subject matter of this action from the jurisdiction of the regulatory laws of a state. Perhaps the Commodity Futures Trading Commission cannot regulate London exchanges, but it does have jurisdiction over accounts, agreements (including options) and transactions on contract markets or any other board of trade, exchange or market.

Appellee also argues that because the Arkansas Securities Act is not in conflict with the federal act, he should not be prevented from enforcing the state regulatory scheme. Where, however, as here, Congress has made it clear that authority conferred by it is exclusive in a given area the states



cannot exercise concomitant or supplementary regulatory authority over the identical activity. *Northern States Power Co.* v. *State*, 447 F. 2d 1143 (8 Cir., 1971); *Rice* v. *Santa Fe Elevator Corp.*, supra, 331 U.S. 218; *Campbell* v. *Hussey*, 368 U.S. 297, 82 S. Ct. 327, 7 L. Ed. 2d 299 (1961).

Appellee, consistent with his argument that Congressional intent to preempt is not manifest, invokes a test he finds in *Northern States Power Co.* v. *State*, supra, i.e.: (1) what is the intent of Congress as expressed in the legislative history of the act (2) how pervasive is the federal regulatory scheme (3) does the nature of the subject require exclusive regulation and (4) is state law an obstacle to federal enforcement. An affirmative answer to all these questions is not required as a basis for finding an implied federal preemption. The court in that case stated these tests only as factors to be considered. Although we would be compelled to answer the fourth question in the negative, if we consider only the terms of the Arkansas Securities Act as presently written, the potential for obstacles is just as important as their existence. See *Rice* v. *Santa Fe Elevator Corp.*, supra. Commodity Futures Trading Commission regulations could change this answer. As to the other questions, our answers are in the affirmative. We have already mentioned the legislative history and the broad scope of the Commodity Futures Trading Commission Act. There was at least a Congressional finding that the nature of the subject matter demanded exclusive federal regulations and we cannot say that this finding was unfounded. See Johnson, The Commodity Futures Trading Commission Act: Preemption as a Public Policy, 29 Vanderbilt Law Review 1. Even if we apply appellee's tests, we find a strong implication that federal preemption was intended.

We do not agree with appellee that preemption will prevent the state from protecting its citizens from fraud. There is no reason why the state cannot prosecute an offender under such provisions as § 41-2203 (Crim. Code, 1976). There is no bar of actions by persons defrauded to recover money ob-

tained from them by fraud. Such actions could not constitute any realistic threat of interference withthe federal regulatory scheme and the act certainly does not afford protection of fraudulent conduct. See *Farmer* v. *United Brotherhood of Carpenters of America*, 430 U.S. 290, 97 S. Ct. 1056, 51 L. Ed. 2d 338 (1977).

Finally, appellee's invocation of the Tenth Amendment is unavailing where the Congress had the power to act and, in acting, manifestly intends to preempt the field. In such a case, the supremacy clause (Art. VI, § 2) clearly has a bearing. See *Rice* v. *Santa Fe Elevator Corp.*, supra, 331 U.S. 218; *Northern States Power Co.* v. *State*, supra, 447 F. 2d 1143. We do not understand appellee to argue that Congress has no power to regulate trading in London commodity options in the United States. It seems rather obvious to us that Congress does have the power under the commerce clause of the United States Constitution. This case does not involve the exercise of power which impairs the integrity of the states on their ability to function effectively, as was the case in *National League of Cities* v. *Usery*, 426 U.S. 833, 96 S. Ct. 2465, 49 L. Ed. 2d 245 (1976) upon which appellant relies. The case involved an attempt by Congress to prescribe minimum wages to be paid to state employees by the states, acting in their sovereign capacity. Clearly, there is no such invasion of the sovereignty of the states involved here. Here the exercise of congressional authority was directed to private citizens, not to the states as states, or to functions essential to their separate and independent existence.

We find that the chancery court had no jurisdiction to act in this proceeding under the provisions of the Arkansas Securities Act, and that the appellee had no standing to bring this action so the decree of the chancery court is reversed and the cause is dismissed.

HICKMAN, J., dissents.



## APPENDIX "B"

### IN THE CHANCERY COURT OF PULASKI COUNTY, ARKANSAS

HARVEY L. BELL, SECURITIES COMMISSIONER FOR THE STATE OF ARKANSAS — PETITIONER

VS. — No. 76-5009

INTERNATIONAL TRADING, LTD., A DIVISION OF GNB, INC.: GNB, INC.: J. R. ROSE AND ARTHUR PALMER — RESPONDENTS

### ORDER

On this day comes to be heard the Demurrer filed in behalf of Respondents and the Petition for Injunction filed by Petitioner and Respondents appearing through their Attorney, Joel Bellows, and Petitioner appearing through his Attorneys, Ted Goodloe and James T. Pitts, and this cause being submitted to the Court for final adjudication by consent of the parties, and from the facts and matters presented and tried on the merits, the Court being well and sufficiently advised finds:

(1) That the Demurrer filed in behalf of Respondents herein should be overruled. That this Court has jurisdiction over the persons and the subject matter of this action and that the Petitioner has standing to bring this suit.

(2) That London Commodity Options offered and sold by Respondents in this State are investment contracts and are

hence securities as defined by Section 13(1) of the Arkansas Securities Act [Ark. Stat. Ann. § 67-1247(1) (Repl. 1966).]

(3) That Respondents, in connection with the offer and sale in this State of investment contracts styled London Commodity Options should be enjoined from directly or indirectly employing any device, scheme or artifice to defraud; making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading; or, engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

IT IS THEREFORE ORDERED that Respondents' Demurrer be and the same is hereby ordered overruled and that the Respondents in connection with the offer and sale in this State of investment contracts styled London Commodity Options be and the same are hereby ordered enjoined from directly or indirectly employing any device, scheme or artifice to defraud; making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading; or, engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

/s/ John T. Jernigan
CHANCELLOR

DATE: Dec. 15, 1976

APPROVED AS TO FORM:



/s/ Joel Bellows
JOEL BELLOWS
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/s/ Ted Goodloe
TED GOODLOE

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Little Rock, Arkansas 72201
Attorneys for Petitioner

## APPENDIX "C"

STATE OF ARKANSAS, }
SCT. }
In the Supreme Court

BE IT REMEMBERED, That at a term of the Supreme Court of the State of Arkansas, begun and held at the Court Room in the City of Little Rock, on the 3rd day, being the first Monday of October, A.D. 1977, amongst others were the following proceedings, to-wit:

On the 7th day of November, A.D. 1977, a day of said term

International Trading Ltd.,
a division of GNB, Inc. et al — Appellant

No. 77-96 — vs.

Harvey L. Bell, Securities Commissioner — Appellee

Appeal from Pulaski Chancery Court
Second Division

Petition for rehearing is denied.

IN TESTIMONY, That the above is a true copy of the Per Curiam of said Supreme Court, rendered in the case therein stated, I, JIMMY H. HAWKINS, Clerk of said Supreme Court, hereunto set my hand and affix the Seal of said Supreme Court, at my office in the City of Little Rock, this 7th day of November, A.D. 1977.

JIMMY H. HAWKINS
Clerk
By Melissa Milhollen
D.C.

Supreme Court, U. S.
FILED
MAR 3 1978
MICHAEL RODAK, JR., CLERK

No. 77-1098

In the

# Supreme Court of the United States

OCTOBER TERM, 1977

HARVEY L. BELL,
Securities Commissioner for the State of Arkansas,
*Petitioner,*

*vs.*

INTERNATIONAL TRADING, LTD.,
A division of GNB, Inc., J.R. Rose and Arthur Palmer,
*Repondents.*

## BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

---

***No.***

---

HARVEY L. BELL,
Securities Commissioner for the State of Arkansas,
*Petitioner,*

*vs.*

INTERNATIONAL TRADING, LTD.,
A division of GNB, Inc., J.R. Rose and Arthur Palmer,
*Repondents.*

---

**BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS**

---

**ARGUMENT**

---

**SECTION 201 OF THE COMMODITY FUTURES TRADING COMMISSION ACT OF 1974 (CFTCA), 7 U.S.C. §§2, 4, PREEMPTED ALL ACTIONS BY A STATE SECURITIES COMMISSIONER WITH REGARD TO COMMODITY OPTIONS.**

To understand the thrust of the preemption provisions of §201 of the Commodity Futures Trading Commission Act of 1974 (CFTCA), a review of the history of the regulation of commodity options must first be made.

The Commodity Exchange Act, 7 U.S.C. §§1 *et seq.*, was enacted in 1922 to govern the commodity futures markets. Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy,* 29 Vand. L. Rev. 1, 2 (1976). It was amended in a hodge-podge fashion over the years in order to bring additional commodities under its regulatory aegis. *Id.* at 3-4.

A commodity option is a contract right, purchased from the option seller for a fee called the "premium," to buy from, or sell to, the option seller, the underlying commodity futures contract at a fixed price called the "striking price," at any time during the life of the option. The striking price is usually the market price of the underlying commodity futures contract on the day that the option is sold. The option period is usually fixed, ranging from one month to a year or 18 months. An option to sell the underlying commodity futures contract is known as a "put." An option to buy the underlying commodity futures contract is known as a "call." It is also possible for the option purchaser to buy both a put and a call on the same commodity at the same time. Such a purchase is known as a "straddle," or, more commonly, as a "double option." Long, *The Naked Commodity Option Contract as a Security,* 15 Wm. & Mary L. Rev. 211, 212-14 (1974). A commodity option is considered a more conservative investment than a commodity futures contract because the risk of loss is limited to the premium paid and is not a concomitant of price fluctuations in the commodity which may lead to additional margin calls. Note, *Federal Legislation for Commodity Option Trading: A Proposal,* 47 So. Cal.L.Rev. 1418, 1424-25 (1974).

Commodity option contracts in various forms have been present in the financial market place for a number of years. Before 1934, contracts on domestic commodities,



such as wheat and cotton, were traded extensively on the major American exchanges. In that year, however, the Commodity Exchange Authority (CEA) banned trading in options on domestic commodities because of the abuses which had developed in the commodity option market. Trading in international, or "world" commodities, including silver, silver coins, platinum, cocoa, plywood, copper, coffee, and world sugar, was not affected, since such items were not subject to CEA jurisdiction. Long, *op. cit. supra,* pp. 213-14.

A "London option," which is involved here, is an option on an underlying futures contract traded on the London commodity exchanges. The options are issued, or "written," by the same exchanges. "World" commodities such as sugar, cocoa, coffee, rubber, silver and copper are traded on the London exchanges. *Clayton Brokerage Co. v. Mouer,* 520 S.W. 2d 802, 804 (Tex. Civ. App. 1975), *rev'd on other grounds,* 531 S.W. 2d 805 (Tex. Sup. Ct. 1975); Long, *op. cit. supra,* p. 214.

Upon this inconsistent scene where options on domestic commodities were prohibited and options on world commodities were not regulated, entered Harold Goldstein. Beginning in April, 1971, he parlayed, in less then two years, an investment of $800 into Goldstein Samuelson, Inc., a corporation with more than 100 outlets throughout the world, selling over 175,000 "naked" options valued at $88 million. *Id.* at 214.

A "naked" option, unlike the London options involved here, is simply a bet between the option seller and the investor that the price of a given commodity futures will rise or fall during a particular time period. The option seller does not maintain adequate inventories of the underlying futures and there generally is no intent that they

will even change hands. A naked option, therefore, is quite unlike conventional commodity option contracts, which normally do involve the actual exchange of the underlying commodity futures contracts upon the exercise of an option. *Id.* at 211-12, 219.

Goldstein's success caused the formation of other option firms. In late 1972 and in 1973, various state securities commissioners, concerned about Goldstein's business practices and recognizing that Goldstein had sagaciously stepped through an unregulated loophole, obtained cease and desist orders closing his business on the grounds that naked options were securities and that he had failed to register them and was selling them fraudulently. *Id.* at 214-17. (In the instant action, there was no allegation or evidence that the London option sold by Respondents were "naked" options.)

These administrative actions caused a run on Goldstein's bank, forced him into bankruptcy, and left sadder but wiser option investors with claims of between $14 and $85 million. *Id.* at 218 n. 28.

The Goldstein debacle inspired recognition of the meager and inconsistent federal and state regulation of commodity futures and commodity options. Congressional hearings commenced in the summer of 1973 to consider legislation overhauling the Commodity Exchange Act. Johnson, *op. cit. supra,* 1-7. These hearings resulted in the enactment by Congress on October 18, 1974, of the Commodity Futures Trading Commission Act of 1974 (CFTCA), 88 Stat. 1388 (1974). Senator Herman Talmadge, chairman of the Senate Committee on Agriculture and Forestry, expressed the intent of Congress in enacting the CFTCA:

> "It was the intent of the Committees to fill all regulatory gaps—to regulate trading in futures and *in options relating to commodities or commodity futures,* because such trading is now poorly regulated, *if it is regulated at all.*" (Italics added.) Staff of Senate Comm. on Agriculture and Forestry, 93d Cong., 2d Sess., Commodity Futures Trading Commission Act of 1974 6 (Comm. Print 1974).



The CFTCA, which became effective on April 21, 1975, provided, after several revisions in committee, as follows:

> "Sec. 201. Section 2(a) of the Commodity Exchange Act, as amended (7 U.S.C. 2, 4), is amended—
>
> • • •
>
> (b) By striking the period [after the words orange juice] and substituting therefore the following: 'and all other goods and articles, except onions as provided in Public Law 85-839, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in: *Provided,* That the [Commodity Futures Trading] Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty'), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 5 of this Act and transactions subject to regulation by the Commission pursuant to section 217 of the Commodity Futures Trading Commission Act of 1974: *And provided further,* That, *except as hereinabove provided* [Italics added], nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws." 88 Stat. 1395 (1974).

As the Senate Committee on Agriculture and Forestry stated:

"The [Senate] Committee Amendment retains the provision of the House bill but adds three clarifying amendments. The clarifying amendments make clear that (a) the [Commodity Futures Trading] Commission's jurisdiction over futures contract markets and other exchanges is exclusive and includes the regulation of commodity accounts, commodity trading agreements, and *commodity options;* (b) the Commission's jurisdiction, where applicable, supersedes State as well as Federal agencies; and (c) Federal and State courts retain their jurisdiction." (Italics added.) S. Rep. No. 93-1131, 93d Cong., 2d Sess. 6 (1974).

Thus it is clear that Congress considered the role of the SEC and the state securities commissioners in the commodity field and eliminated any claim to jurisdiction. The Commodity Futures Trading Commission Act of 1974 clearly preempts the SEC and state securities commissioners from all jurisdiction regarding commodity options and grants exclusive jurisdiction in this area to the new Commodity Futures Trading Commission (CFTC).

The courts have recognized that the securities commissioner of Texas and the SEC were preempted by the CFTCA from bringing suit to enjoin the sale of commodity futures and commodity options on the grounds that they were not registered as securities and were being sold fraudulently. *Clayton Brokerage Co.* v. *Mouer,* 531 S.W.2d 805 (Tex. Sup. Ct. 1975), and *Texas* v. *Monex Int'l Ltd.,* 527 S.W. 2d 804 (Tex. Civ. App. 1975), *applications for writ of error refused* (Tex.Sup.Ct. No. B-5658, December 17, 1975), faced the issue squarely and held that, even if, as the lower court had held, 520 S.W. 2d 802 (Tex. Civ. App. 1975), the London options were securities within the meaning of the Texas Securities Act, the



CFTCA preempted the state securities commissioners from regulation of commodity options and commodity trading advisors. *Accord, SEC* v. *Univest, Inc.,* 405 F. Supp. 1057 (N.D. Ill. 1975), which held that the CFTCA preempted the SEC from jurisdiction.

The CFTC also has repeatedly recognized that the state securities commissioners are preempted from taking action against commodity option dealers and commodity trading advisors.

In a CFTC Staff Interpretative Letter, the Office of General Counsel stated: "The House originally adopted an exclusive jurisdiction provision out of concern over 'A growing list of proposed and actual state regulations and laws moving into areas. . . such as commodity options. . .' and '[c]onfusion in court. . . as to traditional definitions of commodities and securities. . . .'"

"During Senate hearings on the 1974 amendments other so-called 'investment contracts' were then 'being subjected to a withering crossfire of disparate State regulation' and urged that Congress preempt 'well-meaning, but eccentric and ill-informed State attempts to regulate commodities markets under the guise of securities regulation.' See *Hearings on S. 2485, S. 2578, S. 2837 and H.R. 13113, Before the Senate Committee on Agriculture and Forestry,* 93d Cong., 2d Sess. pt. 3 at 681 (1974) (testimony of Glenn Willett Clark, Iowa Supt. of Securities). And, during Senate floor debates, it was recognized: 'Already many State laws are exercising jurisdiction over these same markets. . . . Varied and often conflicting regulation such as this could become a burden on Commerce, if it is not already.' 119 Cong. Rec. S. 11353 (daily ed. December 13, 1973). The Senate adopted a more pervasive grant of exclusive jurisdiction than the House and sought by clarifying language to '. . . make clear that where the jurisdiction of the [Com-

> mission] is applicable, it supersedes State as well as Federal agencies.' S. Rep. No. 93-1131, 93d Cong., 2d Sess. 23 (1974). According to Senator Talmadge, one of the principal sponsors of this legislation, 'This [was to] assure that the affected entities—exchanges, traders, customers, et cetera—will not be subject to conflicting agency rulings.' 120 Cong. Rec. S. 16128 (daily ed. September 9, 1974)." CFTC Interpretative Letter No. 76-19, *State Regulation of Commodity Options Preempted,* CCH Comm. Fut. L. Rep. ¶20,213 (September 29, 1976) at p. 21,158 n. 4.

In *Preemption of Authority to Regulate Trading Advisors,* CFTC Interpretative Letter No. 76-20, CCH Comm. Fut. L. Rep. ¶20,214 (September 29, 1976), the CFTC proclaimed:

> "The legislative history of the [Commodity Exchange] Act indicates that two of the major concerns that led Congress to amend the Act in 1974 were the inability of states adequately to regulate activities that are essentially national in scope and the need to avoid overlapping and duplicative regulation, which might result from the application of diverse and often conflicting state laws.
>
> "Public criticisms of the variegated pattern of non-stop regulation by the states, the Securities and Exchange Commission, the courts and the Commodity Exchange Authority—the predecessor agency to this Commission—were major factors leading to enactment of the CFTC Act." *Id.* at p. 21,161.

Finally, section 6c of the Commodity Exchange Act, 7 U.S.C. §13a-1 (Supp. 1977), now provides that enforcement actions pursuant to the CFTCA shall be brought in federal court. Thus it is clear that Congress intended to centralize regulation of the futures markets and commodity options in a single entity, the CFTC. Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy,* 29 Vand. L. Rev. 1, 30-31 (1976).



Article VI, §2, of the Constitution of the United States provides:

> "This Constitution and the Laws of the United States made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the Supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

Under the "supremacy clause," a state court must recognize federal law, and a federal law in conflict with a state law shall take precedence over the state law. *Testa* v. *Katt,* 330 U.S. 386 (1947); *Smith* v. *O'Grady,* 312 U.S. 329 (1941); *Riggs* v. *Del Drago,* 317 U.S. 95 (1942). This the Supreme Court of the State of Arkansas has correctly done.

At pp. 12-15 of its Petition, the petitioner seeks to persuade the Court that he was merely enforcing a criminal anti-fraud statute. However, it is obvious that the petitioner was acting in his role as a state regulatory agency to carry out the regulatory functions of the statute under which he was commissioned to operate. This action was not a criminal action which would properly be brought by a state attorney general or a county prosecuting attorney. On the contrary, it was a traditional regulatory proceeding, a suit for an injunction to prevent the respondents from selling securities. This is precisely the type of activity which proliferated in the wake of Harold Goldstein and which the enactment of the CFTCA sought to prevent. By regulatory agency, the CFTCA clearly did not mean to include traditional prosecuting officers whose powers are grounded in common law, but rather the state securities commissioners whose powers were established by a statute designed to regulate a specific

industry. Petitioner sets forth an erroneous conclusion when he says that no one but the CFTC could enforce action against persons effecting fraudulent transactions in commodities or from taking action against thieves who were stealing "raw commodities." (Petitioner's Br. 13.) It is obvious that the language of the statute extends only to preempt state regulatory agencies, particularly the state securities commissioners, and furthermore the statute specifically applies only to commodity futures contracts and not to "raw", or cash commodities.

Petitioner admits that the CFTCA is designed to preempt the SEC and the state securities regulators. (Petitioner's Br. 13.) It is not illogical that general anti-fraud statutes may be enforced while the specific regulatory scheme of a state blue sky law is preempted. The latter is the very type of dual regulation which the CFTCA sought to prevent. For example, in this case, the CFTC did not see fit to take any action against the respondents. Furthermore, the CFTCA was designed to eliminate the confusing and conflicting rulings regarding whether a type of transaction in commodities is a security. Rather, the CFTCA placed commodity regulation under its aegis so that state securities regulators would no longer have to go to the limits of the law to protect the public against commodities futures operators. Petitioner contends that by this suit he is not seeking to regulate commodities, but rather to enforce a criminal fraud statute. However, in the first place, an injunction action by the state securities commissioner can be sustained for reasons other than fraud, such as non-registration of the seller or of the security. Secondly, this is the very type of action which proliferated in response to the Goldstein debacle and led to the enactment of the CFTCA. Long, *The Naked Commodity Option as a Security,* 15 Wm. & Mary L. Rev. 211, 215-18 (1974). In these cases, the state securities



regulator stepped into the breach to enjoin commodity firms from selling what they termed and what was determined to be securities. The criminal sanction under section 21 of the Arkansas Securities Act, Ark. Stat. Ann. §671255 (Supp. 1977), is generated out of a civil proceeding and the standard of proof required for someone to willfully violate the Act is much different than for a party being prosecuted under a general criminal law statute. Petitioner sets up a straw man on page 15 by saying that either the State of Arkansas should be preempted completely or not at all. There is nothing inconsistent about preempting a state from regulation in a certain area, in a limited manner but complete as to those limits.

This is illustrated by *Rice* v. *Santa Fe Elevator Corp.,* 331 U.S. 218 (1947). In *Rice,* Congress had amended the United States Warehouse Act to provide that although the "Secretary of Agriculture is authorized to cooperate with State officials charged with the enforcement of State laws relating to warehouses, warehousemen, and their personnel, the power, jurisdiction and authority conferred upon the Secretary of Agriculture under this Act shall be *exclusive* with respect to all persons securing a license hereunder so long as said license remains in effect.'" (Italics added.) *Id.* at 224. The issue was whether, if a warehouse had a federal license, it must also obtain a state license from the parallel state regulatory authority. The Court said that Congress may, if it chooses, take unto itself all regulatory authority over warehouses, but that the Court must discern what the purpose of Congress was. *Id.* at 230. It applied the commonly accepted meaning of the word "exclusive" to conclude that Congress made it clear that it intended no regulation but its own. *Id.* at 235-36. The Court went on to state that if the matter on which the

State asserts its right to act is in any way regulated by the federal act, the federal scheme prevails, even though it may be a more modest, less pervasive regulatory plan than that of the State. *Id.* at 236.

In light of *Rice,* the attempted separation by petitioner of regulatory powers from enforcement powers is a distinction without a difference. Regulatory powers include those of enforcement as well as licensing. Any regulatory scheme which provides for licensing includes enforcement powers for failure to comply with the licensing provisions. The ordinary meaning of enforce is to compel obedience to or cause to be executed. *Commissioner of Public Health* v. *Board of Health of Tewksbury,* 350 Mass. 507, 215 N.E. 2d 745 (1966). "The word 'regulate'", on the other hand, "is one of broad import. It is the word used in the federal constitution to define the power of Congress over foreign and interstate commerce, and he who reads the many opinions of this court will perceive how broad and comprehensive it has been held to be. *City of St. Louis* v. *Western Union Tel. Co.,* 149 U.S. 465 (1893).

> "The term regulate is one of broad import, has a broad meaning, and is very comprehensive in its scope. . . . The power to regulate, it has been said, implies the power to check, and may imply the power to prohibit under certain circumstances; it implies the right to license, to prescribe rules and regulations for the conduct of the business regulated, and to rule and direct. . . .
>
> "The power to regulate, it has been said, carries full power over the thing subject to regulation, and that, in the absence of restrictive words, the power must be regarded as plenary over the entire subject. The power to regulate may include the power . . . to license; to refuse a license, to require bond from



> an applicant therefor, and to require the taking out of a license; to prescribe reasonable rules, regulations, and conditions upon which a business may be conducted or permitted; *to enforce them, and to prescribe punishment for violation thereof; to restrain* [Italics added.] . . . ." *Hollywood Jockey Club, Inc.* v. *Stein,* 133 Fla. 530, 542-45, 182 So. 863, 868 (1938), citing 53 C.J. 1172-76.

Exclusive regulation by the CFTC entails more than registration, notwithstanding the contention of petitioner. (Petitioner's Br. 15.) The appropriate state official would have much less desire to exercise his discretion in enforcing a general criminal fraud statute, with its higher burden of proof, than would the petitioner to bring a civil injunction suit under the Arkansas Securities Act. It is exactly this type of broad discretion which the CFTCA sought to preclude.

## CONCLUSION

The Supreme Court of the State of Arkansas was clearly correct in its decision in this matter for the reasons stated herein, and respondents respectfully pray that petitioner's Petition for a Writ of Certiorari be denied.

Respectfully submitted,

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Supreme Court, U.S.
FILED
MAY 20 1978
MICHAEL RODAK, JR., CLERK

No. 77-1098

# In the Supreme Court of the United States

OCTOBER TERM, 1977

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HARVEY L. BELL, PETITIONER

*v.*

INTERNATIONAL TRADING, LTD., ET AL.

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS*

---

## BRIEF FOR THE COMMODITY FUTURES TRADING COMMISSION AS AMICUS CURIAE

---

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# In the Supreme Court of the United States

OCTOBER TERM, 1977

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No. 77-1098

HARVEY L. BELL, PETITIONER

*v.*

INTERNATIONAL TRADING, LTD., ET AL.

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS*

---

**BRIEF FOR THE COMMODITY FUTURES TRADING COMMISSION AS AMICUS CURIAE**

---

This brief is filed in response to the Court's invitation of March 27, 1978.

## QUESTION PRESENTED

Whether the Commodity Exchange Act, as amended, 7 U.S.C. 1 *et seq.*, precludes the states from applying the antifraud provisions of state securities laws to commodity futures options transactions.

## STATEMENT

The case arose when petitioner, the Securities Commissioner for the State of Arkansas, filed suit in Arkansas state court alleging that respondents had violated Section 1 of the Arkansas Securities Act of 1959, Ark. Stat. Ann. 1947, § 67-1235 (1966 Repl.), in connection with the sale in Arkansas of certain commodity future options.[1] Petitioner contended that the commodity futures options were "securities" under Section 13(*l*) of the Arkansas Securities Act, Ark. Stat. Ann. 1947, § 67-1247(*l*) (1966 Repl.), and sought an injunction restraining respondents from making false and deceptive statements and otherwise engaging in acts and practices proscribed by Section 1 in connection with the offer and sale of these "securities" (Pet. App. 19, 20, 22-23).

The trial court entered judgment for petitioner, but the Supreme Court of Arkansas reversed and ordered dismissal of the suit. The State supreme court held (Pet. App. 25-26) that the amendment enacted in 1974 to Section 2(a)(1) of the Commodity Exchange Act, 88 Stat. 1389, 7 U.S.C. 2, and its legislative history, manifested a "clear intention to

[1] A commodity option is a contractual right to buy, or sell, a commodity or commodity future by some specific date at a specified price. So-called "London options," such as those the respondents sold, are options on futures contracts for certain commodities that are traded on exchanges and markets in London, England. *British American Commodity Options Corp.* v. *Bagley*, 552 F.2d 482, 484-485 (C.A. 2), certiorari denied, No. 77-96, November 7, 1977. See also Pet. App. 23-25.



vest exclusive jurisdiction of the regulation of commodity options in the Commodity Futures Trading Commission and to supersede the jurisdiction of all state and federal agencies." The court concluded that the trial court was without jurisdiction to act under the Arkansas Securities Act, and that petitioner had no standing to bring the suit (Pet. App. 30).

## DISCUSSION

1. The petition does not present a question warranting review by this Court.

a. The ruling of the Arkansas Supreme Court does not conflict with the decisions of any state or federal court. Indeed, all other courts that have considered whether the states are precluded by the 1974 amendments to the Commodity Exchange Act from regulating commodity futures agreements have reached the same conclusion as the Arkansas court.[2] See *Clayton Brokerage Co.* v. *Mouer*, 531 S.W.2d 805, 806 (Tex.), dismissing as moot, 520 S.W.2d 802 (Tex. Civ. App.); *Texas* v. *Monex International, Limited*, 527 S.W.2d 804, 806-807 (Tex. Civ. App.), writ refused, No. B-5658 (Tex.).[3]

[2] In 1974, Congress enacted the Commodity Futures Trading Commission Act, 88 Stat. 1389, amending the Commodity Exchange Act, 42 Stat. 998, 7 U.S.C. 1 *et seq.* For ease of reference, the Commodity Futures Trading Commission Act is referred to herein as the "1974 amendments" to the Commodity Exchange Act.

[3] It has been held that where retrospective relief, rather than injunctive relief, is requested, the states may apply local

b. The practical significance of the ruling below is insubstantial. The Commodity Futures Trading Commission has suspended all offers and sales of commodity options to the general public effective June 1, 1978. 43 Fed. Reg. 16153-16166.[4] Furthermore, legislation is pending before Congress to provide a statutory ban on transactions in London commodity options, such as are involved in this litigation.[5] In light of the imminent cessation of such commodity option sales to the general public, whether a state possesses authority to enforce an antifraud provision of its securities laws against such sales is not a question of substantial importance.

c. The effect of the decision of the Arkansas court is not, as petitioner asserts (Pet. 14), to make the State powerless to protect its citizens from fraudulent practices in connection with commodity transactions. It has been recognized that a state has standing to sue as *parens patriae* to enjoin violations of the antifraud provisions of the Act. *Kelley* v. *Carr*, CCH Comm. Fut. L. Rep. ¶ 20,517, p. 22,134 decided

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regulatory prohibitions to commodity transactions completed prior to April 21, 1975, the effective date of the 1974 amendments to the Commodity Exchange Act. *State by Spannus* v. *Coin Wholesalers, Inc.*, 250 N.W.2d 583, 586-587 (Minn.). That court recognized, however, that exclusive Federal jurisdiction exists over commodity transactions completed after that date. *Id.* at 587.

[4] The regulation does not restrict the offer and sale of commodity options to commercial buyers for use in connection with their businesses. See 43 Fed. Reg. 16153.

[5] See S. 2391, 95th Cong., 2d Sess. (1978); H.R. 10285, 95th Cong., 2d Sess. (1978).



December 5, 1977, (W.D. Mich.), appeal pending, Nos. 78-1091 to 78-1093 (C.A. 6).[6] Moreover, the need for such protection is dubious since the citizens of each state are directly protected by the Commodity Exchange Act, which creates a private right of action for its enforcement. See *Case & Co.* v. *Board of Trade*, 523 F.2d 355, 360 (C.A. 7); *Goodman* v. *H. Hentz & Co.*, 265 F. Supp. 440, 446-447 (N.D. Ill.). See also pp. 12-14, *infra*.

2. On the merits, it is the position of the Commodity Futures Trading Commission that the court below correctly held that the 1974 amendments to the Commodity Exchange Act preclude the states from enforcing state laws regulating commodity option transactions.[7]

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[6] This Court has recognized the standing of a State to sue as *parens patriae* to seek equitable relief for the benefit of its citizens to enjoin violations of federal antitrust law and nuisance activities. See *Hawaii* v. *Standard Oil Co. of California*, 405 U.S. 251; *Georgia* v. *Pennsylvania R. Co.*, 324 U.S. 439; *Pennsylvania* v. *West Virginia*, 262 U.S. 553; *Missouri* v. *Illinois & Chicago District*, 180 U.S. 208.

[7] The action arises in the context of an attempt by the Arkansas Securities Administrator to enforce the antifraud provision of the Arkansas Securities Act with respect to allegedly fraudulent commodity options sales by the respondents, and the assertion by the respondents that the "exclusive jurisdiction" granted to the CFTC in the Commodity Futures Trading Commission Act of 1974 precludes application of the antifraud provision of the Arkansas Securities Act to their activities. Accordingly, the decision of the Arkansas Supreme Court should be construed in light of the factual context in which the case arose, and should not be understood as bearing upon any issue concerning the jurisdiction of the federal Securities and Exchange Commission (SEC).

The Commodity Exchange Act, which establishes a scheme of federal regulation of commodity transactions, was amended in 1974 to extend its coverage and to create the Commodity Futures Trading Commission (CFTC). As part of this legislation, Section 2(a)(1) of the Act was amended to provide:

> [T]hat the [Commodity Futures Trading] Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option" * * *), and transactions involving contracts of sale of a commodity for future delivery * * *. [7 U.S.C. 2.][8]

At the same time, Congress enacted a new provision, Section 4c(b) of the Act, which broadly prohibits the offer or sale of commodity options

> * * * contrary to any rule, regulation, or order of the [Commodity Futures Trading] Commission prohibiting any such transaction or allowing any such transaction under such terms and

[8] The original House bill had limited the CFTC's exclusive jurisdiction to futures contracts, and retained for the SEC a concurrent jurisdiction over other types of futures agreements. See H.R. Rep. No. 93-975, 93d Cong., 2d Sess. 28-29, 87 (1974). The Senate bill, which Congress adopted, made the CFTC's jurisdiction exclusive over all types of commodity future transactions, including commodity options such as are involved in this case. S.Conf. Rep. No. 93-1194, 93d Cong., 2d Sess. 35 (1974). See S. Rep. No. 93-1131, 93d Cong., 2d Sess. 26 (1974); *id.* at 31 ("The [CFTC] will have exclusive jurisdiction over options trading in commodities (but not in securities)").



> conditions as the Commission shall prescribe * * *. [7 U.S.C. 6c(b).]

The court below correctly concluded (Pet. App. 26) that the plain intention of these provisions of the amended Act is to provide the CFTC with comprehensive authority and exclusive jurisdiction, as regards the states, over the regulation of options and other commodity futures transactions. This intention is confirmed in the reports of the Senate Committee on Agriculture and Forestry and the Conference Committee. These reports observed that the exclusive jurisdiction granted the Commission over all futures transactions supersedes the jurisdiction of all state agencies. S. Rep. No. 93-1131, 93d Cong., 2d Sess. 23 (1974); S. Conf. Rep. No. 93-1194, 93d Cong., 2d Sess. 35 (1974). The Conference Committee emphasized further that the authority granted to CFTC would "preempt the field * * *." *Ibid.* Where the controlling statute so unambiguously confers exclusive regulatory authority upon a federal agency, this Court has repeatedly held that state activity in the field is preempted. See, *e.g.*, *Campbell* v. *Hussey*, 368 U.S. 297, 300-302; *Rice* v. *Sante Fe Elevator Corp.*, 331 U.S. 218, 230, 232-236.[9]

[9] In these circumstances, petitioner's contention (Pet. 14-15) that the antifraud provision of Arkansas' securities law is not inconsistent with the federal scheme, even if true, would be of no moment. As this Court recently reaffirmed in *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525:

> [W]hen Congress has "unmistakably . . . ordained," * * * that its enactments alone are to regulate a part of

Petitioner claims, however, that, even if the CFTC has exclusive jurisdiction to "regulate" commodity futures transactions, a state may continue to enforce its securities antifraud provisions on the theory that such laws do not involve licensing or otherwise "regulate" commodity transactions (Pet. 14). The 1974 amendments to the Act, and their legislative history, however, demonstrate that the exclusive jurisdiction given the CFTC preempts application of all state securities laws, including state securities anti-fraud laws, to commodity futures transactions.

There is no indication in the legislative history that Congress intended to draw any distinction between a state's authority to "regulate" and its authority to prohibit fraud. Indeed, there is evidence that Congress affirmatively considered and determined that CFTC jurisdiction over commodity transactions would be exclusive with regard to fraud prohibition as well as other types of regulation. Prior to the 1974 amendments, the last sentence of Section 4c of the Act had provided that

> [n]othing in this section or section 4b [of this Act] shall be construed to impair any state law applicable to any transaction enumerated or described in such sections. [49 Stat. 1494, 7 U.S.C. (1970 ed.) 6c].

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commerce, state laws regulating that aspect of commerce must fall.

*Accord, Burbank* v. *Lockheed Air Terminal, Inc.*, 411 U.S. 624, 633; *Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 141, 142.



This portion of Section 4c had preserved to the states a parallel authority to prohibit transactions also prohibited under Sections 4b and 4c of the Act. Among the transactions prohibited in Section 4b are the sales of commodity futures contracts wherein any person seeks "to cheat or attempt to cheat or defraud [any other person] * * *." 7 U.S.C. 6b. Similarly, Section 4c prohibits the offer or sale of options on commodity futures "contrary to any rule, regulation or order of the [CFTC] * * *." 7 U.S.C. 6c(b). Congress intended that the CFTC would prohibit fraud in connection with commodity option transactions under the broad authority granted by Section 4c, see H.R. Rep. No. 93-975, 93d Cong., 2d Sess. 31, 36-37 (1974) (setting forth CFTC's broad authority and the history of fraud abuse in commodity options trading),[10] and the CFTC has done so in its regulations, 17 C.F.R. 32.9.[11]

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[10] Indeed, as respondents have noted (Brief of Respondents in Opposition 3-5), it was the presence of severe fraudulent practices in the offer and sale of commodity options that led to the 1974 amendments and the decision to expand the CFTC's jurisdiction. See also Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 Vand. L. Rev. 1, 4 (1976).

[11] 17 C.F.R. 32.9 provides:

> It shall be unlawful for any person directly or indirectly—
>
> (a) To cheat or defraud or attempt to cheat or defraud any other person;
>
> (b) To make or cause to be made to any other person any false report or statement thereof or cause to be entered for any person any false record thereof;

The sentence in Section 4c which had allowed the states a parallel authority to prohibit fraud in commodity transactions was removed by the 1974 amendments to the Act. Section 402(d), 88 Stat. 1413. In removing this savings provision, the Conference Report expressly stated that the states are now barred from applying parallel or supplementary laws with respect to the transactions governed by the CFTC under Sections 4b and 4c of the Act:

> The *Conference* substitute adopts the Senate amendment, including the provision in Section 402(d) of the bill which strikes the last sentence of section 4c of the Commodity Exchange Act. The language being struck provides that "Nothing in this section [section 4c] or section 4b shall be construed to impair any State law applicable to any transaction enumerated or described in such sections."
>
> Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned. Therefore, if any substantive State law regulating futures trading was contrary to or inconsistent with Federal law, the Federal law would govern. In view of the broad grant of authority to the Commission to regulate the futures trading industry, the Conferees do not contemplate that there will be a need for any supplementary regulation by the States. [S. Conf. Rep. No. 93-1194, *supra*, at 35-36.]

(c) To deceive or attempt to deceive any other person by any means whatsoever; in or in connection with an offer to enter into, the entry into, or the confirmation of the execution of, any commodity option transaction.



Senator Curtis, who sponsored the amendment removing the last sentence of Section 4c, stated that "[a]ll of the transactions referred to in that sentence are covered by the existing act as amended by the [1974] bill," and concluded that it was necessary to remove the sentence "to assure that Federal preemption is complete." 120 Cong. Rec. 30464 (1974).

The CFTC believes that this express legislative history demonstrates that its authority under Sections 4b and 4c of the Act is exclusive,[12] and that the 1974 amendments preclude the States from exercising parallel regulatory authority over fraud in connection with commodity futures transactions. See *Rice* v. *Santa Fe Elevator Corp.*, *supra*, 331 U.S. at 232-234.[13]

[12] See note 8, *supra*.

[13] The facts in *Rice* parallel the instant case. In Rice, this Court held that the United States Warehouse Act, 39 Stat. 486, as amended, 7 U.S.C. 241 *et seq.*, precludes the States from the regulation of grain warehouses. In reaching this conclusion, the Court relied strongly on the fact that the federal Act originally had allowed supplementary state regulation, but had been amended to remove a provision protecting state authority and to provide exclusive jurisdiction to the Secretary of Agriculture. The Court held that the Act "terminat[ed] the dual system of regulation" and concluded that "the matters regulated by the Federal Act cannot be regulated by the States * * *." 331 U.S. at 234. Accordingly, where, as in this case, the subject of the state regulation "is in any way regulated by the Federal Act," the federal authority is preclusive. *Id.* at 236.

Petitioner argues (Pet. 12-13), that it is anomalous to conclude that the 1974 amendments preclude the states from exercising regulatory jurisdiction over fraud in connection with commodity futures transactions because a 1975 Senate report on subsequent legislation states that the exclusive jurisdiction of the CFTC over those transactions

> does not prevent the States from enforcing their criminal antifraud statutes. [S. Rep. No. 94-73, 94th Cong., 1st Sess. 5 (1975).]

There is no anomaly between the congressional intent in 1974 to preclude state jurisdiction over commodity futures transactions and the statement in the 1975 Senate report that enforcement of state "criminal antifraud statutes" is not precluded.

The statement in the 1975 Senate report says only that the states may continue to apply their criminal antifraud statutes to commodity futures transactions. Viewed against the 1974 legislative history that Congress intended the CFTC to have exclusive authority over such transactions, the 1975 statement reflected simply the normal principle that the CFTC's exclusive jurisdiction does not necessarily preempt the entire body of general state legislation that only tangentially affects commodity transactions.[14] See *Rice*

[14] We note also that the 1975 legislation did not concern the substantive provisions of the Act that set forth the exclusive jurisdiction of the CFTC, but was enacted to extend the dates by which the CFTC was to adopt regulations under the Act. See S. Rep. No. 94-73, *supra*, at 3. In this situation, the subsequent legislative history may not be entitled to great weight. See *e.g.*, *Regional Rail Reorganization*



v. *Santa Fe Elevator Corp.*, *supra*, 331 U.S. at 236-238. Exclusive federal authority is not necessarily inconsistent with the states' enforcement of their general criminal fraud statutes or the states' enforcement of federal prohibitions by incorporating those prohibitions, where appropriate, into the states' criminal fraud law.[15] Parallel enforcement efforts of this nature were not clearly precluded by the exclusive jurisdiction provisions of the 1974 amendments. The relevant legislative history prohibits "supplementary regulation" by the states: it does not by its terms also prohibit supplementary enforcement of federal regulations by the states. See S. Rep. No. 93-1194, *supra*, at 36.

But the possible application of general criminal antifraud laws is not presented in this case. Petitioner filed this action seeking civil injunctive relief under the authority of the State's specific securities regulation law (Pet. 5).[16] Any possible inconsistency

*Act Cases*, 419 U.S. 102, 132; *Waterman Steamship Corp.* v. *United States*, 381 U.S. 252, 269; *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 348-349.

[15] Similarly, there is no necessary inconsistency with exclusive federal authority when the State sues as *parens patriae* to enjoin conduct that violates commodity trading regulations established by the CFTC. See p. 4, *supra*.

[16] Arkansas seeks enforcement of a state regulation based on Section 10b-5 of the SEC regulations, 17 C.F.R. 240.10b-5. The antitfraud regulation adopted by CFTC, note 10 *supra*, contains different language, expressly to avoid "uncritical application of securities laws, principles and practices." 40 Fed. Reg. 26505.

between the 1974 legislative history and the 1975 Senate report does not indicate that Congress has repealed or modified Section 402(d) of the 1974 amendments by reinstating authority in the states to engage in supplementary regulation of commodity futures transactions.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1978.

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